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JAPAN-EC RELATIONS 1983: THE WINDING ROAD

Summary

The lingering effects of the global recession fueled the fires heating up relations between Japan and the European Community (EC) during 1983, spoiling the recipe in some cases, but also producing some positive results with implications for future trends. Economic issues dominated bilateral relations, but the issue of the imbalance in manufactured goods trade spilled over into other areas. As before, the Europeans concentrated on trade flows into the EC from Japan, but also paid more attention to shipments in the opposite direction by calling for increased access to Japan's markets. Together with the Japanese, they also expended a great deal of effort, not without success, promoting cooperative links between corporate antagonists in the hope that it would revitalize European firms, provide stable markets for Japanese exports, and reduce the possibilities for future disputes. While this is evidence of increasing sophistication in the instruments Japanese and European policymakers employ, the more traditional tools of tariffs and voluntary restraints still comprise important parts of each government's arsenal.

Trade Issues

The European Side - During 1983 the most critical issue in European eyes -- the bilateral trade imbalance -- remained solidly entrenched as an irritant. While the global recession slowed the growth of the European economies to about 1 percent in 1983, it failed to restrain Japanese exports to the EC, which increased over 5 percent. Japan's current-account balance with the EC as a whole showed a surplus of $8.5 billion for the first 10 months of

1983, almost 7 percent more than the same period in 1982 (see Table 1). Exports of manufactured goods as a percentage of total Japanese exports to the EC also grew to 97.3 percent, up from 88.4 percent a year ago. European manufactured goods also took a larger share of total EC exports to Japan, rising 3 percent to 69.9 percent in 1983.

An integral part of this pattern, and another point of contention, is the emphasis by Japanese exporters on sales of a particular product in a country. The intense competition by Japanese firms for shares of the European national markets is accused of creating a flood of Japanese imports that adversely affects domestic producers. In 1983, exports of Japanese video cassette recorders (VCRs) to the Netherlands rose 32 percent, deliveries of Japanese autos to France rose 40 percent, and exports of Japanese quartz watches to Ireland ballooned 766 percent in the first half of the year. The Japanese hold significant positions in many products, including cars (32 percent of Norway's market), video equipment (80 percent of the entire EC market) and bearings (16.5 percent of West Germany's total). While exports of some products - notably automobiles - are already under bilateral restrictions, magnitudes of this sort have prompted the EC to seek community-wide voluntary export restraints from Japan for the first time, and in February 1983, an agreement was concluded covering several sensitive products including machine tools, watches and video cassette recorders (see JEI Report 9B, March 11, 1983).

This agreement set quantitative limits only on exports of Japanese VCRs, color TV sets and components, but placed 9 other items in a closely monitored group. While the accord did moderate the growth of color TV exports to the EC to between 3 percent and 6 percent, and actually reduced the level of VCR exports 10 percent from 1982, as shown in Table 2, it did not have much effect on watches (up 120 percent from 1982), forklifts (up 25 percent) or cars (up 23 percent). Despite these problems, the EC and Japan agreed in November of 1983 to raise the numerical limits on VCR exports for 1984 to 5.05 million units, an increase of 11 percent, but leave unchanged provisions covering the other items.

Another rough spot concerns Japanese exports of digital audio disk (DAD) equipment, which hold a majority share of the market in the Community. The Europeans, not wishing to repeat their experience with video cassette recorders, attempted to pre-empt Japanese dominance of the market by doubling the tariff on DAD imports in October 1983. The Japanese immediately cried foul and threatened to complain to the mediation council of the General Agreement on Tariffs and Trade (GATT). The issue is particularly sensitive because the Europeans are breaking with international norms by imposing a specific restriction on a product which has not been marketed for more than three years. Ironically, DAD technology was developed by Japan's Sony Corp. and the Netherland's N.V. Philips, and the action was seen as a blow to similar arrangements in the future. The Japanese view this as pre-emptive protectionism which would seriously threaten free trade if allowed to go unchallenged (see JEI Report 47B, December 16, 1983).

The Japanese Side - Parallelling the focus on trade from Japan to the EC, shipments in the opposite direction also received a great deal of

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attention. The issue that generated the loudest complaints was the low level of manufactured exports to Japan. EC officials point to a Japanese ratio of manufactured imports to total imports that has remained stuck at around 20 percent for the last 10 years. By comparison, the ratio for the EC has been hovering around 40 percent during the same period (see Table 3). The Europeans claim that this low figure is evidence of the "closed" nature of the Japanese economy and have pressed for an active import promotion campaign by the Japanese as well as the liberalization of Japanese tariff and nontariff barriers. These complaints were formalized by a petition to the GATT under Article 23 which requires bilateral consultations as the first stage in the mediation process. After a few fruitless diplomatic skirmishes, the EC ministers moved to the second stage of the process, asking for GATT arbitration in spite of the verbal promise by EC Vice-Chairman Etienne Davignon to Foreign Minister Shintaro Abe that it would be handled through direct bilateral negotiations. This call for multilateral consultations brought loud protests from the Japanese government accompanied by countercharges against the European system of tariffs specifically aimed at trade with Japan. Faced with the prospect of an attack on its tariff system, the EC decided not to pursue the GATT process.

Another flap occurred over the Japanese decision to purchase the American Boeing 767 jetliner over the European Airbus Industrie's A300 aircraft. When the decision was announced, the French -- who thought they had a verbal commitment from Japan on the Airbus -- were outraged. The subsequent claims and counterclaims in the French and Japanese press did nothing to enhance the atmosphere.

The Japanese have not sat idly by during this period. The general market liberalization measures over the past year clearly affect the Europeans as well as the Americans. Immediately on the heels of their market liberalization package in January of 1983, Japan announced a second package that accelerated a number of tariff reductions and strengthened administrative procedures to facilitate trade, including more lenient import inspection procedures. While the package was well received in Europe, the Japanese were forced to agree to the voluntary restraints announced in February. The economic stimulus package in October 1983 was also hoped by the Japanese to pull in more imports. They continued unilateral reductions even during a recession which speaks clearly of their desire to maintain good relations with their trading partners. Japanese investors have also stepped up their activities in Europe and several commitments to open new TV and VCR plants on the continent have been made. While some European firms see this as an end run around the wall of tariffs and quotas that exist, deals such as that between Honda and British Leyland have been highly successful and mutually beneficial.

Despite intensive use of trade-restrictive tools, the Europeans and Japanese continue to emphasize that cooperation is the real key to future relations. The principle is enshrined in policy statements and is reiterated, almost ritualistically, at each high-level meeting. Jaundiced observers note that the statements constitute an empty litany and point out that few, if any, cooperative agreements exist as a result of government encouragement. Indeed, most cooperative link-ups have been negotiated at the private business level and owe little to government support. Joint ventures such as the Sony-Philips DAD project illustrate how mutually advantageous deals can be struck even in

the area of high technology. The Acclaim car, produced by Honda and British Leyland, won critical praise for its design and construction while racking up strong sales. Other joint ventures are appearing with Italian auto firms. Trade-related cooperation is beginning to make a definite impact in the EC economic arena.

Unfortunately, beyond purely trade-related ventures, cooperation has yet to really materialize. In science/technology and development assistance, the two fields where cooperation could yield substantial benefits, only very preliminary contacts have been made. Again, private organizations are taking the lead. For example, the Japan Chemical Industry Association and the European Council of Chemical Manufacturing Federations have called for cooperation in the fields of environmental problems and technology transfers. Development assistance to Southeast Asia remains one area of mutual interest and consultations to coordinate aid occur on a regular basis. Thus, the cooperative spirit will eventually spill over from trade to other areas.

A Trilateral Comparison

Trade - One concept that guides the Common Market ministers in discussions with Japan is the trilateral EC-US-Japan relationship. The ministers feel that to operate as a firm foundation for free international trade, each leg of the trilateral relationship must be equally strong. In this context, they fear that the weak link is the EC-Japan partnership. This conclusion is, in fact, supported by the statistics. Nor is the tie likely to ever fulfill European hopes because their trilateral concept is too optimistic. Japan-EC relations differ from Japan-U.S. relations in significant respects for historical, institutional and psychological reasons.

In terms of the sheer magnitude of trade, EC-Japan trade has consistently fallen far short of Japan-U.S. and EC-U.S. trade. From the trade data summarized in Table 5, it is clear that EC-Japan trade is less than half of either EC-U.S. or U.S-Japan trade. EC-Japan trade is also unbalanced, with the ratio of surplus/deficit to total trade at a consistently and significantly higher level. This problem is also expressed by the low export-import ratio for EC-Japan trade in comparison with the other two. While hitting an all-time low of 34.3 percent in 1980, it improved in 1984, rising to 43.9 percent. The EC is a more important trading partner for Japan, accounting for 13 percent of Japan's total trade, than vice versa, with Japan constituting only 3 percent of the EC's total trade. This difference is responsible, in part, for the psychological environment that surrounds the relationship.

Besides lagging behind the United States in absolute quantities traded, the Common Market has a more shallow economic relationship with Japan. There are only half as many European firms with investments in Japan as U.S. firms, and almost half of these companies are completely held by the parent firm - eliminating the close contact with a Japanese partner that the majority of American firms consider desirable. In return, Japan has invested much more in the United States -- almost $14 billion by the first quarter of 1983 -- than it has in Europe (just over $3 billion at the end of the same period). Though more difficult to quantify, the web of commercial relationships between Japan and America is broader and finer than that linking Japan and the EC. Moreover, Japanese trading companies are much more active in the United States than they

are in Europe, both in terms of volume and personnel. Finally, while American trade with the Asian-Pacific region in now larger than its trade with Europe, the EC's trade is focused increasingly on Africa and South Asia.

Security - Economic links are not the only component of a relationship. Political, social and security policies are also a factor. Here, too, the EC finds itself falling short of the U.S.-Japan relationship. The U.S.-Japan mutual defense treaty, which both parties regard as the bulwark of stability in the region, has no EC-Japan counterpart. Although a security relationship of sorts exists through the loose alliance of "Western" nations, it is not at all on a par with the American partnerhsip. At the 1983 Williamsburg summit, Prime Minister Nakasone took great pains to establish a link between security in Western Europe and security in Northeast Asia by focusing on the common threat of Soviet SS-20 missile deployments. But a relationship built purely on summit statements without treaty commitments cannot have any real force in the international arena. Both sides now face the challenge of putting meat on the bones of their lofty plans. Geographic separation poses a near-insurmountable obstacle to the realization of any real security relationship in the immediate future, not to mention the political problems.

Institutional, Psychological Factors - Institutional differences also account for inequality of relations among the trilateral partners, although this may change in 1984. Until the February 1983 trade agreement was concluded, the EC was virtually unable to present Japan with a unified position on any issue. Individual governments pursued their separate interests and presented a confusing and contradictory set of signals. The Italians, for example, vehemently opposed the agreement between Honda and British Leyland and even pursued the matter in EC Council meetings. As long as the EC Council was unable to agree on a unanimous position on issues such as technology transfers, foreign buy-outs and industrial policy, individual companies and governments were free to act in their own interests. While the Japanese may have been guilty of playing one EC member off against another in some cases, the Europeans certainly made it an easy task.

The U.S. government, on the other hand, presents a relatively united front to the Japanese. While Congress does wander off in its own direction, the administration has done a good job of providing a consistent position on the issues. Despite some bureaucratic infighting, the discipline that the Reagan Cabinet has brought to the conduct of foreign trade policy has made it at once easier and harder for the Japanese -- easier in that goals are clear, but harder to find an acceptable compromise. Perhaps taking a page from President Reagan's book, the Europeans have now closed ranks on trade issues. Given the recent success of the EC maneuvers, members may indeed begin to act in concert on other issues as well. While national interests will continue to limit the scope of consensus, the trend toward more unity among EC members is likely to accelerate.

Psychological factors have an important yet elusive influence on bilateral relations, and again, a comparison is useful. The most serious psychological factor is the Japanese perception that the Europeans consider them second-class citizens. There have been occasions when Japanese officials were not invited to important meetings even though they were present, and they often feel that the Europeans only give lip service to the process of

negotiation. For their part, the Europeans say they find the Japanese obtuse and secretive, making negotiations trying at best. The more open style of Prime Minister Nakasone has helped relieve this perception, as has the EC's new economic cohesion.

On the whole, the Europeans paid no attention to Japan's economic position until it suddenly burst onto the scene in the 1970s as a potent international competitor. In 1965, trade with the EC was only 5 percent of Japan's total trade and amounted to less than one-fifth of Japan's trade with the United States. The subsequent growth of trade with Europe between 1965 and 1973 was explosive, doubling in the first five years, doubling again in the next two years, and doubling again the next year (1972-1973). While the same patternwas followed in the United States, Americans were more familiar with Japan because of the postwar occupation. Additionally, the United States had been absorbing Japanese exports since the mid-1950s. Japanese goods, especially high-visibility items such as cameras and electric appliances, were well entrenched in American society -- in contrast to Europe where they were practically unknown. As a result, Japan's export surge was much more traumatic for Europeans than for Americans. The suddenness and weight of the Japanese presence left both the Europeans and Japanese struggling to adjust to each other -- along with other pressures in the 1970s. Only recently have the two begun to deal with each other in a more mature fashion, reflecting internal political developments in each country.

Hurdles Ahead

The last year presented a mixed bag of successes and setbacks, but generally set a positive tone. The February agreement on VCRs and other items has a life of three years which will lend some stability to trade in these goods. The Europeans have shelved their plans for GATT arbitration, and while the issue may be reopened at any time, it is not a likely occurrence. Even after the EC tariff decision on DAD equipment, Japan was willing to conclude an agreement creating a wisemen's council to study scientific and technical cooperation. Generally, decision makers on both sides showed new sophistication and commitment in 1983 to building better relations.

Make no mistake, there are some very dark clouds that could make 1984 a complete washout. Foremost among these is the DAD equipment issue. The European action is very disquieting to the Japanese because it smacks of industrial policy through trade restraint. By attempting to protect a brand new market, the EC is clearly trying to foster its own electronics industry at the expense of the Japanese. The fact that it concerns a high-technology product is even more disturbing because if the practice catches on in other countries, the Japanese drive to capitalize on knowledge-intensive products is squarely threatened. The Japanese plan to take the EC to the GATT unless the EC accepts a compromise - of which there is little indication. It is ironic that this potentially heated dispute centers on a product of Euro-Japanese cooperation, and the Japanese are making it clear that commercial links may suffer in the future.

While tie-ups in high-technology areas may be on hold, the trickle of agreements between car makers also threatens to become a flood. There are rumors that several ailing European auto manufacturers are considering joint

engineering and production agreements with Japanese competitors based on the model of the highly successful Honda-British Leyland arrangement. Several Italian, and even some French firms, are considering deals that will allow them to learn Japanese methods while producing competitive products. Japanese firms are anxious to establish links as a means of increasing market access and gaining a leg up on other Japanese competitors. Whether the EC tries to regulate this new scheme or acquiesces is now being debated, with the stronger European auto makers dead set against it.

Another possible flash point is the continued rapid growth in exports of several products that are included in the February voluntary export restraint agreement. Exports of cars, quartz watches, bicycles and machine tools have all increased between 20 percent and 120 percent during 1983 and the Europeans are disappointed over implementation of the agreement. Since the levels of exports for 1984 were determined last October, individual EC members may begin to petition the EC Commission for waivers permitting them to take restrictive action against particular Japanese exports should they continue to grow at unacceptable rates. Nothing is clearer than the imperfect ability of the Japanese government to control the performance of the private sector -- putting to rest further accusations about Japan Inc.

A very important field of products has yet to receive much attention, but certainly promises to hold center stage in the coming decade: telecommunications and computer equipment. As Japanese firms compete for primacy at home in the rapidly evolving information marketplace, it will position them to be fierce competitors abroad. Europeans are well aware of this and are mulling plans to subject European firms to the same pressures, hoping to ready effective resistance to the Japanese challenge. Cooperation between private firms is one option as the Japanese become net exporters of technology, but a lapse back into protectionism is a very strong possibility. Both sides will be preparing policies and sharpening arguments in anticipation of a struggle over this vital area.

Outlook

The art of problem-solving made great strides in 1983 and a strategy for 1984 is expected to build on this. While high-level biannual consultations have been institutionalized for several years, they have recently begun to exert more than a ceremonial role. Foreign Minister Shintaro Abe's visit to Europe in early 1983 was an important gesture and another visit by a high-ranking official is quite possible. The London summit later this year will present another opportunity to forge closer relations with European leaders and Prime Minister Nakasone may try to duplicate his "Ron and Yasu" success with other heads of state.

Europeans have tended to be heavy-handed, as with the DAD tariff doubling for example, but it has, more often then not, proven useless - witness the GATT Article 23 debacle. Their future actions depend, at least in part, on how America handles its relations with Japan. One could almost say the Europeans rode America's coattails during 1983 to obtain agreements with the Japanese. Both the February VCR agreement and negotiations setting 1984's levels occurred on the heels of American-Japanese accords on voluntary restrictions or market liberalization. Perhaps Tokyo felt more pressure to

reach an agreement with the EC once agreement with the United States had been reached. Whether this fortuitous timing can be duplicated this year is doubtful, although January and February are busy months with meetings between all sides in Japan.

Trade will continue to dominate the EC's goals vis-a-vis relations with Japan in 1984, but more focus will center on the liberalization of Japan's financial system and the internationalization of the yen -- paralleling American plans. While the yen managed to hold its own against the rising dollar in 1983, all of the major European currencies lost ground to both the dollar and the yen (see Table 4). This will tend to take the competitive edge off many Japanese exports and may help European exports to Japan as the Common Market's economy begins to revive in 1984. The EC has already sold three bond issues in the Japanese market worth Y20 billion each ($84 million at current exchange rates). These have been well received and more issues will likely be floated this year. Nonetheless, the Europeans are calling for increased use of the yen in international transactions and more foreign participation in Japanese financial markets. Finally, it is interesting to note that while 1983 saw more anti-dumping complaints lodged with the EC by European industry (over 60 filings), less than ten concerned Japan and of these, only two led to the definitive imposition of countervailing duties.

The post-election political situation in Japan will require a new assessment by the Europeans of Prime Minister Nakasone's ability to negotiate seriously. Indeed, with the delicate balance of power in the Diet and the current focus on the FY 1984 budget, the Japanese may be unable and unwilling to tackle politically dangerous foreign economic problems. On the other hand, an expanding economy in 1984 will relieve some of the pressure on the government to take a tough stance on import policy. With the strong prospect that Mr. Nakasone will call new elections sometime this year, the Japanese government may try to delay making any significant moves. If, however, the coalition government proves to be solid, action on the foreign front may proceed as soon as the budget for the new fiscal year is passed. There are a great many "ifs" to consider when sizing up the current Japanese Cabinet and the next few months should tell whether it will still be around this fall.

The government is not the only important actor in Japan. One must also consider the business sector, particularly financial institutions, in judging the capacity for changes in the Japanese economy. While most of these welcome the proposed liberalization of capital markets, financial experts are unanimous in saying that any plan must be implemented gradually to allow for adjustment. Industry also welcomes the greater freedom that an internationalized yen would bring, but fears possible disruption in the markets. Significant obstacles to rapid reform of Japan's capital markets exist and will not easily be overcome.

Japan-EC relations, while continuing to develop and broaden, are likely to wind up and down in 1984. The potential for widely diverging interests exists if the European economies cannot pull out of the doldrums and put their own affairs in order. Starting out on the right foot, as Japan and the EC have done, is no guarantee that the year will have a happy ending.

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Table 1: Japan's Trade with the EC

(in billions of dollars)

Year	Exports (f.o.b.)	Percentage Change	Imports (f.o.b.)	Percentage Change	Balance	Export/ Import Ratio
1973	$ 4.872	31.9%	$ 3.193	61.2%	$ 1.679	153%
1974	6.465	32.7	4.020	25.9	2.445	161
1975	6.012	-7.0	3.411	-15.1	2.601	176
1976	7.977	32.7	3.651	7.0	4.326	218
1977	9.831	23.2	4.233	15.9	5.598	232
1978	11.996	22.0	6.106	44.2	5.890	196
1979	13.44	12.1	7.656	25.4	5.788	176
1980	17.195	27.9	7.878	2.9	9.317	218
1981	18.894	9.9	8.552	8.6	10.341	221
1982	17.064	-9.7	7.560	-11.6	9.504	226
1983*	15.152	5.0	6.645	2.7	8.507	228

*Figures are for January-October 1983; Percent changes calculated over same period 1982.

Source: Japan Tariff Association, Summary Report: Trade of Japan

Table 2: Performance of Japanese Exports to the EC under VER
January-October 1983

(percent change)

Cars	24.5%
Color TVs	3.3
TV Tubes	5.7
Machine Tools	2.1
Forklifts	26.3
Tape Cassette Decks	17.9
Quartz Watches	123.6
Motorcycles	-16.4
Video Cassette Recorders	-11.8

Source: Ministry of Finance, Japan Exports and Imports.

Table 3: Manufactured Goods as a Percentage of Total Imports*

Year	Japan	EC
1955	10%	22%
1960	22	29
1965	23	33
1970	30	44
1971	29	43
1972	30	45
1973	30	44
1974	23	38
1975	20	39
1976	20	40
1977	20	43
1978	25	46
1979	24	46
1980	22	44
1981	22	39
1982	23	40
1983	25**	58***

*Manufactured goods defined as SITC categories 5 - 8.
**Figures for first ten months 1983.
***Figures for first three months 1983.

Table 4: Exchange-Rate Movements Against the Yen

(percentage change from previous month)

	Pound Sterling	Deutsche Mark	French Franc
1983			
January	-6.76%	-2.71%	-2.67%
February	-1.23	-0.18	-0.24
March	-1.93	1.52	-1.12
April	3.28	-1.40	-4.49
May	0.11	-2.43	-2.77
June	0.79	-0.93	-0.86
July	-1.25	-1.42	-1.37
August	-0.15	-1.71	-1.76
September	-0.87	-0.46	-0.89
October	-4.10	-1.53	-2.64
November	-0.43	-2.44	-1.93
December	-2.55	-2.79	-3.05

(percentage change December to December)

1977	-7.56%	-7.82%	-13.55%
1978	-13.72	-6.46	-8.50
1979	33.55	29.76	27.74
1980	-8.58	-25.95	-24.92
1981	-13.26	-4.74	-13.84
1982	-9.76	-0.93	-9.69
1983	-11.08	-13.98	-19.96

Sources: Bank of Japan and New York Exchange Market Quotations.

Table 5: EC-Japan-U.S. Trade -- Volume and Shares

(millions of dollars)

Trade Of:	Total Exports	Export Trade as a Percentage of Total Exports		Total Imports	Import Trade as a Percentage of Total Imports	
EC		Japan	US		Japan	US
1980	$307,822	2.55%	11.99%	$375,723	4.43%	14.23%
1981	297,711	2.87	12.26	350,340	5.39	13.90
1982	281,349	2.69	13.57	315,707	5.41	15.17
1983*	128,278	3.06	16.46	142,794	6.25	15.70
Japan		EC	US		EC	US
1980	$129,807	12.83%	24.16%	$140,528	5.58%	17.37%
1981	152,030	12.43	25.40	143,290	5.63	17.65
1982	138,831	12.29	26.17	131,931	5.39	18.33
1983**	119,296	12.70	28.62	102,908	6.46	19.32
US		Japan	EC		Japan	EC
1980	$223,966	9.29%	23.86%	$249,308	12.52%	14.48%
1981	236,254	9.23	21.74	264,143	14.23	15.68
1982	211,217	9.80	22.21	247,606	15.22	17.10
1983*	99,635	9.97	23.50	122,657	15.58	17.05

*Figures cover first six months 1983.
**Figures cover first ten months 1983.

Sources: Ministry of Finance, Eurostat, U.S. Department of Commerce.